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Nos. 14-840, 14-841

In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *ET AL.*,
Respondents.

ENERNOC, INC., *ET AL.*,
Petitioners,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *ET AL.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF ON THE MERITS FOR RESPONDENT PJM INTERCONNECTION, L.L.C. SUPPORTING PETITIONER

Vincent P. Duane
Senior Vice President and
General Counsel
PJM Interconnection, L.L.C.
2750 Monroe Blvd.
Audubon, PA 19403
(610) 666-4367
vincent.duane@pjm.com

Craig Glazer
Vice President-Federal
Government Policy
PJM Interconnection, L.L.C.
1200 G Street, N.W., Suite 600
Washington, D.C. 20005
(202) 423-4743
craig.glazer@pjm.com

Barry S. Spector
Counsel of Record
Paul M. Flynn
Wright & Talisman, P.C.
1200 G Street, N.W.
Suite 600
Washington, D.C. 20005
(202) 393-1200
spector@wrightlaw.com
flynn@wrightlaw.com

Counsel for Respondent PJM Interconnection, L.L.C.

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Becker Gallagher Cincinnati, OH Washington, D.C. 800.890.5001

CORPORATE DISCLOSURE STATEMENT OF PJM INTERCONNECTION, L.L.C.

Pursuant to Rule 29.6 of the Rules of this Court, PJM Interconnection, L.L.C. ("PJM"), states that it is a limited liability company ("L.L.C.") organized and existing under the laws of the State of Delaware. PJM is an independent regional transmission system operator authorized by the Federal Energy Regulatory Commission ("FERC") to administer an open access transmission tariff, operate energy and other markets, and otherwise conduct the day-to-day operations of the bulk power system of a multi-state region. *See Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257 (1997), *reh'g denied*, 92 FERC ¶ 61,282 (2000), *modified sub nom. Atl. City Elec. Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002).[1]

Under Delaware law, the members of an L.L.C. have an "interest" in the L.L.C. *See* Del. Code Ann. tit. 6, § 18-701 (2015). PJM members do not purchase their interests or otherwise provide capital to obtain their interests. Rather, the PJM members' interests are determined pursuant to a formula that considers various attributes of the member, and the interests are used only for the limited purposes of: (i) determining the amount of working capital contribution for which a member may be responsible in the event financing cannot be obtained;[2] and (ii) dividing assets in the

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[1] PJM also is an approved Regional Transmission Organization. *PJM Interconnection, L.L.C.*, 101 FERC ¶ 61,345 (2002).

[2] Under the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Rate Schedule FERC No. 24, the amount

event of liquidation. PJM is not operated to produce a profit, has never made any distributions to members, and does not intend to do so (absent dissolution). In addition, "interest" as defined above does not enter into governance of PJM and there are no entities that have a 10% or greater voting interest in the conduct of any PJM affairs.

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of capital contributions received from all PJM members combined is capped at $5,200,000. Because PJM has financed its working capital requirements, there have been no member contributions to date, and none are expected.

TABLE OF CONTENTS

CORPORATE DISCLOSURE STATEMENT OF PJM INTERCONNECTION, L.L.C. i

TABLE OF AUTHORITIES vi

INTRODUCTION 1

SUMMARY OF ARGUMENT 5

ARGUMENT 10

A. Nothing in the Text of the FPA Forecloses FERC's Conclusion that It May Regulate System Operators' Payments to Demand Response that Chooses to Participate in the Wholesale Market 10

1. Demand Response Is Not a "Sale of Electric Energy," and FPA Section 201(b) Therefore Does Not Foreclose FERC's Authority to Regulate Its Participation in the Wholesale Markets 12

2. The Establishment of the Terms of Demand Response Participation in the Wholesale Market Is Not a "Matter" Subject to Regulation by the States, and FPA Section 201(a) Therefore Does Not Foreclose FERC's Authority to Regulate the Terms of Such Participation 14

a. The *EPSA* Court Overlooks that the States Do Not Regulate All "Matters" by Which an Electricity User Reduces Its Consumption of Electricity or Reduces the Effective Cost for the Electricity It Needs 16

b. The "Matter" at Issue Is a Distinct Commercial Transaction in Which the Electricity User's Exercise of Its Choice to Reduce Consumption, and Thereby Instantaneously Relieve the Wholesale Market of Its Responsibility to Ensure that Increment of Consumption Is Satisfied, Is Compensated 19

c. The *EPSA* Court's Crabbed View that Demand Response *Must* Be Solely "Part of" the Retail Market Is at Odds with This Court's Recent Guidance that Certain Activities that Affect Both Wholesale Rates and Retail Rates May Be Addressed, in Separate and Appropriate Ways, by Both FERC and the States 27

3. Claims that the Text of the FPA Plainly Forecloses FERC Regulation of Demand Response Participation in Wholesale Markets Cannot Be Squared with Other Statutory Text in Which Congress Expressly Encourages Demand Response Participation in Wholesale Markets 29

B. Because Demand Response Offers into the Wholesale Market Directly Affect the Price in that Market, FERC Reasonably Concluded that it May Regulate Demand Response Offers in the Wholesale Market as a "Practice Affecting" Wholesale Market Prices 36

CONCLUSION 43

TABLE OF AUTHORITIES

CASES

Cal. Indep. Sys. Operator Corp. v. FERC,
372 F.3d 395 (D.C. Cir. 2004) 37, 39, 41

Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984) 10, 11, 36

City of Arlington v. FCC,
133 S. Ct. 1863 (2013) 10, 36

Comcast Corp. v. FCC,
600 F.3d 642 (D.C. Cir. 2010) 35

Elec. Power Supply Ass'n v. FERC, 753 F.3d 216 (D.C. Cir. 2014), *cert. granted*, 83 U.S.L.W. 3835 (U.S. May 4, 2015) (No. 14-840) & *consolidated sub nom. EnerNOC, Inc. v. Elec. Power Supply Ass'n*, 83 U.S.L.W. 3835 (U.S. May 4, 2015) (No. 14-841) *passim*

Jersey Cent. Power & Light v. FERC,
810 F.2d 1168 (D.C. Cir. 1987) 22

Miss. Indus. v. FERC,
808 F.2d 1525 (D.C. Cir. 1987) 37

Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC,
475 F.3d 1277 (D.C. Cir. 2007) 14

New England Power Generators Ass'n v. FERC,
757 F.3d 283 (D.C. Cir. 2014) 37, 41

N.J. Bd. of Pub. Utils. v. FERC,
744 F.3d 74 (3d Cir. 2014) 1

NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n, 558 U.S. 165 (2010) 25

Oneok, Inc. v. LearJet, Inc., 135 S. Ct. 1591 (2015) 7, 16, 27, 28

Wis. Pub. Power, Inc. v. FERC, 493 F.3d 239 (D.C. Cir. 2007) 30

ADMINISTRATIVE DECISIONS

Cal. Indep. Sys. Operator Corp., 91 FERC ¶ 61,256 (2000) . 23

Demand Response Compensation in Organized Wholesale Energy Markets, Order No. 745, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,322, *order on reh'g & clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012). 4, 36, 37

Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations To Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act, 78 Fed. Reg. 19,880 (Apr. 2, 2013) 24, 26

Frequency Regulation Compensation in the Organized Wholesale Power Markets, Order No. 755, 2008-2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,324 (2011), *reh'g denied*, Order No. 755-A, 138 FERC ¶ 61,123 (2012) 25

New Power Co. v. PJM Interconnection, Inc., 98 FERC ¶ 61,208 (2002) 30

PJM Interconnection, L.L.C., 92 FERC ¶ 61,059 (2000) 23

PJM Interconnection, L.L.C., 99 FERC ¶ 61,227 (2002) 23

PJM Interconnection, L.L.C., 142 FERC ¶ 61,067 (2013) 25

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,048, *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *reh'g denied*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part & remanded in part sub nom. Transmission Access Policy Study Grp. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. N.Y. v. FERC*, 535 U.S. 1 (2002) 29, 30

Wholesale Competition in Regions with Organized Electric Markets, Order No. 719, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,281 (2008), *as amended*, 126 FERC ¶ 61,261, *order on reh'g*, Order No. 719-A, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,292, *reh'g denied*, Order No. 719-B, 129 FERC ¶ 61,252 (2009) 20

STATUTES AND REGULATIONS

16 U.S.C. § 824(a) 15, 22

16 U.S.C. § 824(b) 11

16 U.S.C. § 824(b)(1) 6, 11, 12

16 U.S.C. § 824(e) 3

16 U.S.C. § 824e(a) 11, 36

18 C.F.R. § 35.34(j)(iv)(B)(4) 21

26 U.S.C. § 179D 18

26 U.S.C. § 25C 18

26 U.S.C. § 25D 18

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) 24

Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) *passim*

OTHER AUTHORITIES

Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Rate Schedule FERC No. 24 3

Black's Law Dictionary (10th ed. 2014) 12, 31

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INTRODUCTION

PJM Interconnection, L.L.C. ("PJM") is a Federal Energy Regulatory Commission ("FERC")-approved regional transmission organization ("RTO" or "system operator") responsible for ensuring that the supply of electricity matches—instantaneously—its consumption by over 61 million people in a region encompassing the District of Columbia and thirteen Mid-Atlantic and Midwestern states, extending from Chicago to the New Jersey suburbs of New York City, and to the Outer Banks of North Carolina.

To help satisfy those consumers' demand for reliable electric service at the lowest reasonable cost, PJM operates competitive wholesale markets, including: (1) a FERC-regulated wholesale energy market, which is the commercial venue for the matching of generation and consumption; (2) a FERC-regulated capacity market, which is the means for securing forward commitments for the installation of sufficient resources to meet the region's expected peak needs; and (3) FERC-regulated markets to procure certain "ancillary services" that meet critical reliability needs of the bulk power system.

Reflecting the "technological advances [that] have revolutionized the way electric power is generated and transmitted," *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74, 81 (3d Cir. 2014), PJM's wholesale markets offer an array of sophisticated products and services that employ competitive market forces to meet the electric grid's engineering and operational requirements. PJM's markets provide price signals designed to induce, as need be, either an increase or decrease in the supply, or conversely, a decrease in the consumption, of

electricity and other electricity-related products and services, such as voltage support or reserves, when and where needed to ensure immediate, near-term, and long-term system reliability.

These products accommodate changes in both generation and consumption, i.e., the dynamic injections into and withdrawals from the regional grid that PJM is required to keep in balance at all times. In service of this effort, PJM has developed rules that pay for beneficial reductions in consumption by electricity users of all types, including steel mills, college campuses, sports complexes, office parks, and shopping centers, as well as aggregated groups of residential end-users. To a large extent, these consumption reductions offered into PJM's competitive energy market, known as demand response, are arranged, facilitated, or aggregated from end-users by intermediaries, such as the Petitioners in Case No. 14-841, reflecting the development of a new business segment within the electric industry.[3] Whether on their own or through such aggregators, these end-users, particularly larger consumers managing energy procurement as a cost of business, often invest in modern advanced energy control and metering

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[3] On PJM's system, at least, virtually all end-user demand response is provided through such intermediaries. For convenience, PJM uses the terms "electricity user" and "demand response provider" in this brief to refer both to industrial, commercial, and residential users who reduce their consumption, *and* to the aggregators or energy management firms that act as intermediaries and package or present the consumption reductions to system operators. These intermediaries sell or resell a distinct and important service, but, as the court below found, it is not a sale or resale of electric energy.

technologies to better enable them to delay or forego discretionary consumption, thereby reducing some of the demand that PJM must operate its system to satisfy.

In part, this technological innovation has been driven by the needs of system operators like PJM to ensure that demand response in fact provides the intended reductions to wholesale demand and its attendant system balancing and wholesale rate reduction benefits. Demand response providers do not merely decline to consume, such as by simply turning off a light switch. The demand response provider in PJM's markets must satisfy a variety of conditions and requirements, including end-user metering requirements, providing data to support usage estimates, posting adequate credit, cooperating with reviews by the system operator and the regional independent market monitor, maintaining the capability to receive and act upon the system operator's dispatch instructions, and verifying to the satisfaction of the system operator that the promised reduction in consumption was in fact provided. *See, e.g.*, Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Rate Schedule FERC No. 24, Schedule 1 §§ 1.5A, 3.3A.

PJM is a "public utility" as defined in the Federal Power Act ("FPA"), section 201(e), 16 U.S.C. § 824(e). As is the case with all PJM market rules, its rules for demand response transactions, which directly affect the price of wholesale power sold in PJM's markets, are filed with and accepted by FERC as part of PJM's filed tariff. PJM's demand response rules have been part of its FERC-filed tariff for fifteen years, and the

participation of demand response providers in PJM's markets has grown dramatically over that time, both in terms of the quantity of demand response provided and the variety of markets that accommodate demand response. Demand response participates, for example, in PJM's energy market, its capacity market, and several of its ancillary services markets. Last summer, PJM registered over 8,000 megawatts of demand response, meaning that electricity users were identified that were prepared to reduce, in aggregate, that quantity of the demand PJM's energy market must serve. This is roughly comparable to the *entire peak consumption* of Washington, D.C. and its Maryland suburbs.

FERC Order 745,[4] the rulemaking at issue in this case, is directed at FERC-jurisdictional wholesale electricity market operators that allow demand response to participate in their "energy" markets, i.e., the market, described above, for matching generation and consumption. PJM is therefore one of the entities to which Order 745 is directed. Order 745 did not order PJM to include demand response in its energy market; it directed only changes to the level of compensation PJM pays for the demand response that PJM's

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[4] *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,322, *order on reh'g & clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012), *vacated*, *Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014) (*"EPSA"*), *cert. granted*, 83 U.S.L.W. 3835 (U.S. May 4, 2015) (No. 14-840) & *consolidated sub nom. EnerNOC, Inc. v. Elec. Power Supply Ass'n*, 83 U.S.L.W. 3835 (U.S. May 4, 2015) (No. 14-841).

previously approved tariff allows to participate in that market.

PJM strongly supports demand response participation in its energy market and its other wholesale markets for electricity-related products and services. PJM intervened in the *EPSA* proceeding on judicial review of Order 745, and joined the brief of intervenors in that case to the extent it supported FERC's jurisdiction over demand response participation in wholesale markets.

In this brief, PJM again supports FERC's conclusion that it has jurisdiction over the terms by which demand response participates in the wholesale markets. PJM does not address the question posed by the Court on the merits of FERC's determination of the appropriate level of compensation to demand response.

SUMMARY OF ARGUMENT

FERC reasonably concluded that it is empowered by the FPA to regulate the rules used by wholesale market operators to pay for end-user reductions in electricity consumption and recoup those payments through adjustments to wholesale market rates. Those reductions in wholesale market demand undeniably affect rates for the sale of energy in PJM's wholesale market. FERC therefore reasonably asserted FPA jurisdiction over these practices affecting rates for sales of electric energy at wholesale in interstate commerce.

Applying this Court's well-established approach to issues of statutory interpretation, the first question is whether FERC's assertion of jurisdiction is foreclosed by the text of the FPA. It is not. Only two provisions of the FPA, both in section 201, have been cited to

claim that statutory text forecloses FERC jurisdiction over the terms of demand response participation in the wholesale energy market. Yet FPA section 201(b)(1), which provides only that FERC's authority extends to sales at wholesale of electric energy, but not to "any other sale of electric energy," does not bar FERC from setting the terms of demand response participation in wholesale markets. The court below agreed with FERC that demand response is not a "sale of electricity."

Nor does FPA section 201(a), also relied upon by the *EPSA* court, unambiguously foreclose FERC's assertion of authority. That section counsels only that federal regulation under the FPA extends "only to those matters that are not subject to regulation by the States." While the *EPSA* court objects that FERC has improperly intruded into "the retail market," the FPA neither uses nor defines the term "retail market." The "matter" at issue here patently is *not* a retail sale subject to regulation by the states; rather, it is a distinct commercial transaction with PJM whereby the electricity user sells its right to consume electricity in a given hour, which, given the instantaneous effect of changes in consumption, results in an attendant reduction in the wholesale demand that PJM would otherwise have to serve for that hour. That transaction, financial in nature, is not a sale of electricity, but a sale of the end-user's right to purchase electricity. To obtain the system and market benefits realized when the electricity user chooses not to exercise its right to consume, PJM makes a payment (to the electricity user or, more often, its intermediary) in consideration for the sale of that right.

The *EPSA* court's assignment of that demand response transaction to an exclusive "retail market" domain conflicts with this Court's recent observation, in a closely analogous environment, that the "Platonic ideal" of "a clear division between areas of state and federal authority does not describe the natural gas regulatory world," *Oneok, Inc. v. LearJet, Inc.*, 135 S. Ct. 1591, 1601 (2015)—an observation that is just as apt a description of the electric regulatory world—at least as to the unique character of voluntary demand response.

The *EPSA* court's overly expansive view of the "matter" at issue errs by confounding two distinct activities: (1) an electricity user buying electricity from a retail supplier; and (2) that electricity user taking other independent actions to reduce its need for electric energy or its total cost of meeting that need. The states simply do not regulate every "matter" by which an electricity user chooses to reduce its consumption or control its total cost of meeting its energy needs; a user could comply with every state-approved term of the retail sale yet still choose to reduce consumption for reasons outside the state's electric regulatory domain. The election to reduce consumption—without intruding on *any* state retail ratemaking function—can serve as the foundation for a distinct commercial transaction in the wholesale market, which brings together, at a price acceptable to both parties, the electricity user's willingness to forego an increment of consumption that the wholesale market would otherwise be obligated to satisfy and the wholesale market operator's objective to match generation and consumption in the most economically efficient manner. This transaction, comparable to closing out an option to purchase a

stated amount of a commodity, is thus a conventional commercial transaction that sits comfortably in the wholesale market and serves an important and useful function in that market. The *EPSA* court's reductionist view of demand response as a "fiction," "metaphysical," or simply "declining to act," thus ignores the industry fundamentals that give rise to that transaction and the commercial logic embodied in that transaction. The *EPSA* court simply assumes away demand response's entirely proper function in wholesale markets, and ultimately seems to rest on no more than a suspicion that, if a retail electricity user is any part of the transaction, it *must* by definition lie outside FERC's jurisdiction.[5]

In contrast to the cited provisions of FPA section 201, there *is* statutory text in which Congress directly speaks to the precise question at issue. In section 1252(f) of the Energy Policy Act of 2005, Congress established as national policy that "unnecessary barriers to demand response participation in energy, capacity and ancillary services markets shall be eliminated." As the referenced markets encompass FERC-regulated wholesale markets, and as

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[5] To be clear, PJM does not contend that every action an electricity user takes that is outside the state regulator's domain is thus *inside* FERC's regulatory domain. Not every part of the economy is subject to state or federal electricity regulation. And indeed not every action an end-user may take to manage the amount and cost of its electricity use is subject to regulation. But when a reduction in consumption is *offered into the wholesale market*, providing the system operator an advantageous means of matching generation and consumption, the payment and other terms of the offer *are* subject to FERC regulation because they directly affect the wholesale rate.

"participation" in a market is commonly understood as transacting in that market, section 1252(f) embodies specific Congressional intent that demand response should have fair access to transacting in wholesale markets, including the wholesale energy market at issue in Order 745. Congress specifically mandated elimination of barriers to demand response participation in wholesale markets even while, elsewhere in section 1252, it also explicitly supported retail demand response programs. The *EPSA* court took a single-minded approach, confining demand response entirely to "the retail market," yet never squaring its conclusion that FERC cannot set terms for demand response participation in wholesale markets with this express Congressional statement favoring demand response participation in the wholesale market.

Moving to the second step of the statutory analysis, i.e., whether the agency's construction of the statute as permitting the exercise of authority is reasonable, there is little doubt that FERC reasonably concluded that it could regulate, under FPA section 206, the price and terms of demand response offers in the wholesale market as a "practice affecting" the rates in that market. In the wholesale energy markets, demand response offers directly affect the market-clearing price in exactly the same way that generation offers affect the clearing price in such markets. FERC's conclusion easily satisfies the judicial guidance that section 206 allows FERC to regulate practices that "directly" affect the wholesale rate, and not those that are "remote" from that rate.

ARGUMENT

FERC concluded that it has authority under the FPA to regulate the rules used by system operators to pay for end-user reductions in electricity consumption and recoup those payments through adjustments to wholesale market rates. Under this Court's precedents, whether labeled as "jurisdictional," the statutory interpretation "question in every case is, simply, whether the statutory text forecloses the agency's assertion of authority, or not." *City of Arlington v. FCC*, 133 S. Ct. 1863, 1871 (2013); *see also EPSA* at 220. If not foreclosed, i.e., "the statute is silent or ambiguous with respect to the specific issue," the question is whether the agency's conclusion that it has such authority rests on a "permissible construction." *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984). As shown below, no text in the FPA unambiguously forecloses FERC from regulating payments and other terms for demand response that participates in the wholesale market, and FERC's interpretation that it may regulate the terms of such demand response market participation as a practice that directly affects the price in the wholesale market is a reasonable and permissible construction.

A. Nothing in the Text of the FPA Forecloses FERC's Conclusion that It May Regulate System Operators' Payments to Demand Response that Chooses to Participate in the Wholesale Market

Under *Chevron* step one, the Court inquires whether Congress has "directly spoken to the precise question at issue," such that "the intent of Congress" is

"unambiguously expressed," *Chevron*, 467 U.S. at 842-43. Here, nothing in the FPA unambiguously expresses a Congressional intent that FERC must reject proposals from wholesale market operators regarding the rules to apply when an electricity user chooses to offer in the wholesale market to reduce consumption served by that market, thereby changing the "rate," 16 U.S.C. § 824e(a), for "sale[s] of electric energy at wholesale," 16 U.S.C. § 824(b)(1), in that market. As shown below, the electricity user's offer to reduce consumption is not an offer of a "sale of electric energy" that FPA section 201(b) puts beyond FERC's reach. 16 U.S.C. § 824(b). Nor is the offer into the wholesale market to reduce consumption, which the system operator otherwise would be required to satisfy, a "matter" subject to exclusive regulation by the states such that FPA section 201(a) would put it beyond FERC's reach. As section 201 is the only "text" of the FPA on which Respondents and the court below rely for their *Chevron* step one arguments, and that text contains nothing to "foreclose" FERC regulation of the participation of demand response in wholesale markets, FERC's view of its authority plainly survives *Chevron* step one.

What is more, there *is* an "unambiguous[] express[ion]" of "the intent of Congress" on "the precise question at issue," i.e., that demand response *should* be allowed to participate in the wholesale markets. *See Chevron*, 467 U.S. at 842-43. In section 1252(f) of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) ("EPAct 2005"), Congress declared as national policy that "unnecessary barriers to demand response participation in energy, capacity and ancillary service markets"—which as shown below clearly

encompass the FERC-jurisdictional markets—"shall be eliminated." Congress's explicit directive that demand response should be spared unnecessary barriers to "participation" in wholesale markets (i.e., "the *act* of *taking part in*" wholesale markets, *Black's Law Dictionary* 1294 (10th ed. 2014) (emphasis added)), negates any argument that the FPA plainly "forecloses" FERC regulation of that very participation.

1. Demand Response Is Not a "Sale of Electric Energy," and FPA Section 201(b) Therefore Does Not Foreclose FERC's Authority to Regulate Its Participation in the Wholesale Markets

The court below, and the Respondents, both argue that the "text" of the FPA "foreclose[s]" FERC's conclusion that it can regulate the terms of demand response participation in the wholesale market. *See EPSA* at 220-225; Opp'n to Pets. for Writ of Cert. 16. Respondents (but not the court below) rest this argument in part on FPA section 201(b)(1), which establishes that the FPA's provisions apply to "the sale of electric energy at wholesale in interstate commerce," but not "to any other sale of electric energy." 16 U.S.C. § 824(b)(1). Respondents argue that because demand response reduces the amount an electricity user purchases at retail, and pays the user for the reduction, it "in effect" changes the amount the user pays for the energy it *does* consume, such that FERC's regulation of demand response is tantamount to *ultra vires* regulation of a retail sale. Opp'n to Pets. for Writ of Cert. 18.

Yet, as discussed in the following section, electricity users take actions of many sorts, including actions

motivated by explicit financial incentives, that change how much they buy of a good or service. While these actions, and any financial incentives that might induce them, affect how much the user spends overall for electricity, neither the action nor the incentive changes the state-approved rate for the retail sale or any other state-approved term or condition of that sale. The user reduces the quantity of electricity it buys at retail, but it is perfectly free to do so. It is not making up the difference through a separate unregulated retail purchase; it is simply buying less. Nor is the demand response payment in any way attributable to the electricity the user continues to buy at retail. To the contrary, the payment in the demand response transaction is made solely with respect to electricity the user chose *not to purchase*. Demand response is not an effort by the wholesale market operator to reduce the electricity user's price for the electricity the user *still* purchases—the wholesale market is not benefiting from that continued consumption. Rather, the wholesale market derives immediate and concrete benefits from the user *not buying* a quantity of electricity, so much so that the wholesale market operator is willing to pay the user to relinquish the right the user otherwise enjoys to buy that electricity.

Contrary to Respondents, therefore, the demand response transaction is neither a retail sale of electricity, nor is it "in effect" a retail sale of electricity. Demand response is its own transaction, with mutual benefits for, and mutual consideration from, the electricity user and a third party—the wholesale market operator—that is not a retail seller. The state-approved rates and terms for the electricity the user continues to buy at retail are not changed whatsoever,

and the user's continued retail purchase forms no part of the consideration for the demand response transaction. That the FERC-regulated demand response transaction indirectly affects the user's remaining retail purchase (just as many other things may affect the user's consumption level or its total cost of meeting its electricity needs) does not remove demand response from FERC's jurisdiction. *See Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277, 1280 (D.C. Cir. 2007).

Unlike Respondents, the court below rightly disavowed reliance on this particular "text" of the FPA. The *EPSA* court expressly agreed with FERC's conclusion that "demand response is not a sale [of electric energy] at all." *EPSA* at 221. The court necessarily acknowledged, therefore, that "we do not base our conclusion on the 'any other sales' language of § 201(b)(1)." *EPSA* at 222 n.1. Consequently, FPA section 201(b)(1) does not contain any identified "text" that "foreclose[s]" FERC's conclusion that it can regulate the system operator's terms for demand response participation in the wholesale market.

2. The Establishment of the Terms of Demand Response Participation in the Wholesale Market Is Not a "Matter" Subject to Regulation by the States, and FPA Section 201(a) Therefore Does Not Foreclose FERC's Authority to Regulate the Terms of Such Participation

The only other "text" of the FPA that the *EPSA* court and Respondents rely upon as "foreclos[ing]" FERC's regulation of demand response offers in the wholesale market is the policy declaration in FPA

section 201(a) that federal regulation under the FPA extends "'only to those matters that are not subject to regulation by the States.'" *EPSA* at 221 (citing 16 U.S.C. § 824(a)). While the court below claims to rely on "the statutory scheme as a whole," *EPSA* at 222 n.1, it relies for its conclusion principally on FPA section 201(a), finding that "demand response, while not necessarily a retail *sale*, is indeed part of the retail *market*, which, as the statute and case law confirm, is exclusively within the state's jurisdiction." *Id.* Respondents similarly rely on FPA section 201(a). Opp'n to Pets. for Writ of Cert. 17.

Yet, while the *EPSA* court objects that FERC has improperly intruded into "the retail market," the FPA does not use, much less define, the term "retail market." And, as explained below, the "matter" at issue is *not* the retail sale to the electricity user (plainly regulated by the state); rather, it is a distinct commercial transaction in the nature of closing out an option, whereby the electricity user, whose consumption is otherwise included in the wholesale demand that the system operator is obliged to supply, sells its right to consume electricity in a given hour in exchange for a payment from the market operator. The *EPSA* court's attempt to assign that demand response transaction to an exclusive "retail market" domain has the misguided impact of raising barriers that neither Congress, FERC, the industry, nor the states themselves, perceive as either necessary or appropriate. Congress in EPAct 2005, by supporting and encouraging *both* retail *and* wholesale demand response; this Court, by recognizing that "a single physical action could be the subject of many different laws [including] FERC's regulation of this

physical activity for purposes of wholesale rates [and] other form[s] of state regulation that affects those rates," *Oneok*, 135 S. Ct. at 1600; and FERC and the states that have concurrently pursued demand response programs at both the retail and wholesale levels for years, all reflect the common-sense view that certain activities that affect both retail and wholesale markets may be addressed in their separate and appropriate ways by both state and federal regulators. Demand response, which is not itself a retail or wholesale sale but which instantaneously reduces demand in both retail and wholesale markets, with distinct effects on the separate rates in each market, is perhaps the perfect example of such an activity.

Therefore, as shown in detail below, FPA section 201(a) does not unambiguously foreclose FERC's assertion of authority.

a. The *EPSA* Court Overlooks that the States Do Not Regulate All "Matters" by Which an Electricity User Reduces Its Consumption of Electricity or Reduces the Effective Cost for the Electricity It Needs

The court below fundamentally errs in expansively characterizing as a "matter" exclusively "subject to [state] regulation" not only the rates and terms of the retail electric energy sale, but also any actions or transactions a firm or enterprise may *independently* undertake to control its total cost of meeting its energy needs. *EPSA* at 221-22. The *EPSA* court was evidently unable to see commercial logic or economic sense in a market that would pay electricity users *not* to consume, i.e., for "declining to act," *EPSA* at 221.

Failure to grasp the true economic character of demand response participation in wholesale markets led the court to conclude wrongly that demand response is solely "part of" the retail market, *id.* at 222 n.1, and thus a "matter" outside FERC's jurisdiction. *Id.* at 221-22. However, contrary to the court below, many things may affect an electricity user's total electricity costs, and the state simply does not regulate them all. Just as the user may make choices—not themselves regulated by the state—that reduce its consumption and total energy cost, its choice to reduce consumption in response to payments from the wholesale market is not itself a matter subject to state regulation. Far from being a "fiction" or "metaphysical," as the *EPSA* court characterizes it, *EPSA* at 221, 223, demand response participation in the wholesale market is a distinct, independent, and commercially meaningful transaction that, at its essence, is similar to other wholesale energy market transactions, as well as transactions commonly found in other centralized marketplaces or exchanges.

The *EPSA* court's view of the "matter" at issue errs, first, by sweeping too broadly and conflating two distinct activities: (1) an end-user buying electricity from a retail supplier; and (2) an electricity user taking other independent actions to reduce its need for electricity or its total cost of meeting that need. The former is plainly a retail purchase of electricity (subject only to state regulation); the latter is *not* an electricity purchase at all, at retail or wholesale. For example, an electricity user that reduces its electricity consumption for heating and cooling by purchasing and installing a geothermal heat pump will reduce its total costs of buying electricity at retail, but the purchase of the heat pump plainly is not a retail electricity purchase that is

within the state utility commission's regulatory domain. Moreover, the user could receive a tax credit[6] or a manufacturer's rebate, each of which contributes to reducing the electricity the user consumes and the total amount it spends on electricity over the course of a month, yet neither the tax credit nor the manufacturer's rebate would be a retail electric market transaction subject to state regulation. Similarly, consider a large industrial customer whose state-regulated retail rate changes throughout the day to reflect the changing value of energy under changing system conditions. That electricity user could separately enter a financial transaction with a bank to hedge against excessive swings in that retail rate. Payments the firm receives under that hedge undeniably change its total energy costs, yet the financial hedge plainly is not a "matter" that is subject to state retail utility regulation.

To be clear, this is *not* to say that, simply because such actions are outside the domain of state electricity regulators, those activities must therefore default to *federal* electricity regulation. Congress did not intend through the FPA to divide the entire national economy between state and federal electricity regulation. To the

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[6] *See* 26 U.S.C. § 25D (permitting income tax credit of 30% of cost of qualified geothermal heat pump put in service on or before December 31, 2016). *See also* 26 U.S.C. § 25C (permitting income tax credit for cost of various residential energy efficiency property improvements, including roofing, windows, insulation, and highly efficient central air conditioners and electric heat pumps put in service from 2009 to 2014); 26 U.S.C. § 179D (permitting income tax credit for the cost of commercial building energy efficiency improvements that reduce energy consumption by 50% or more, and that were placed in service from 2006 to 2013).

contrary, as the examples above suggest, other regulators, such as the Internal Revenue Service (in the case of tax credits) or the Commodity Futures Trading Commission ("CFTC") (in the case of financial hedges), may be implicated. The question under the FPA is whether a "matter" over which FERC is otherwise clearly granted authority under FPA sections 206 and 201(b) as a practice directly affecting wholesale rates for electric energy must nonetheless be placed outside FERC's regulatory reach because the "matter" is one that is solely subject to regulation by the states. If, however, a "matter" is *not* solely regulated by the states, that means only that the FPA section 201(b)(1) savings clause does not apply; FERC jurisdiction still arises only when permitted by the FPA's affirmative grants of authority.

b. The "Matter" at Issue Is a Distinct Commercial Transaction in Which the Electricity User's Exercise of Its Choice to Reduce Consumption, and Thereby Instantaneously Relieve the Wholesale Market of Its Responsibility to Ensure that Increment of Consumption Is Satisfied, Is Compensated

Demand response participation in the wholesale market is a "matter," like the examples discussed above, by which an electricity user takes independent action to reduce its consumption or otherwise control its total costs for the electricity it uses. That "matter" is embodied in a separate transaction with a commercial logic quite comparable to financial transactions in other commodity marketplaces. From the electricity user's perspective, it can comply with all

applicable, state-established rates, terms, and conditions of the retail electricity purchase, yet still decide whether to reduce consumption, even where such a decision might be motivated in part by a credit or other incentive that, while not changing the stated retail rate, does impact the electricity user's total cost.[7]

From the wholesale market operator's perspective, reductions in electricity users' demand offer a variety of direct, beneficial effects to grid reliability and wholesale market competition but, absent an emergency, the system operator cannot force such reductions. Under FERC-approved reliability standards, PJM must conduct its grid operations and

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[7] For purposes of this brief, PJM assumes (as FERC did in Order 719) that the state can adopt a rule or policy, as part of its regulation of the retail sale, that the purchaser in that retail transaction will require state permission to provide demand response in the wholesale market. *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,281, at PP 154-56 (2008), *as amended*, 126 FERC ¶ 61,261, *order on reh'g*, Order No. 719-A, 2008–2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,292, *reh'g denied*, Order No. 719-B, 129 FERC ¶ 61,252 (2009). Whether that assumption is correct or not, however, does not affect whether the wholesale market terms, when the electricity user *does* participate in the wholesale market, is a matter subject to state regulation. Such a state permission requirement would be comparable to state permits required for construction or operation of a generator, which the generator must obtain from the state before it participates in markets for wholesale sales of electric energy or for the related FERC-regulated services in those markets, like capacity and ancillary services, that affect those wholesale sales. That the state can grant or deny such permits does not make all activities of generators a "matter" subject only to state regulation.

markets pursuant to enforceable standards setting an expectation that electricity consumption will not be involuntarily curtailed more often than one day in every ten years.[8] Similarly, FERC requires that system operators like PJM have "exclusive authority" for maintaining "the short-term reliability" of their defined portion of the bulk power system, 18 C.F.R. § 35.34(j)(iv)(B)(4), and therefore must ensure that generation constantly adjusts to match every change in consumption.[9] Ensuring continuous satisfaction of end-user demand, at whatever level the electricity user chooses, is thus an ineluctable fact of life for a system operator like PJM. Because the wholesale electricity markets are the commercial vehicle by which PJM arranges this constant matching of generation to consumption, this results in the end-user effectively having the right to dictate the wholesale supply that

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[8] *See NERC Reliability Standard BAL-502-RFC-02*, North American Electric Reliability Corp. (May 23, 2011), http://www.nerc.com/files/BAL-502-RFC-02.pdf.

[9] As the governments of the U.S. and Canada explained in their joint report on a widespread black-out in 2003, "electricity flows at close to the speed of light . . . and is not economically storable in large quantities;" it therefore "must be produced the instant it is used." *Final Report on the August 14, 2003 Blackout in the United States and Canada: Causes and Recommendations*, U.S.-Canada Power System Outage Task Force, 6 (Apr. 2004), http://www.ferc.gov/industries/electric/indus-act/reliability/blackout/ch1-3.pdf. Failure to match generation and consumption can cause system frequency to depart from the sixty cycles per second standard; extreme frequency deviations can damage generating equipment, and in the most severe cases can lead to total system collapse, absent such last-resort actions as shedding selected loads. *Id.* at 7.

PJM's market must purchase to meet the wholesale demand.[10]

PJM's (and other RTOs') responsibility to ensure that consumption is matched at all times by generation, and that the desire to consume is involuntarily denied only in the rare emergency, reflect the broader public policy that ensures electricity is "always on" and effectively establishes a right to consume. As Congress declared in section 201(a) of the FPA, "the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest," 16 U.S.C. § 824(a), making regulation of electricity wholesales "necessary in the public interest." *Id.* There is generally considered to be a "compact" arising from this declared public interest that affords consumers a right to "universal, non-discriminatory service." *Jersey Cent. Power & Light v. FERC*, 810 F.2d 1168, 1189 (D.C. Cir. 1987) (Starr, J., concurring). The electric market is thus quite unlike typical commodity markets. In the ordinary course, a seller does not transact with a buyer that enjoys a right established by federally approved standards and public policy imperatives to have its demand met at all times, under all system conditions, and in whatever quantities the buyer desires.

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[10] As the U.S. Government Accountability Office ("GAO") explained to Congress in its 2004 report on demand response, "[b]ecause of the need to precisely match supply and demand at all times, wholesale and retail markets are operationally joined." U.S. Gov't Accountability Office, GAO-04-844, *Electricity Markets: Consumers Could Benefit from Demand Programs, but Challenges Remain* 2 (2004) ("GAO DR Report").

But there is a conventional commercial transaction designed for managing just such an occasion. Sellers of a good or commodity routinely sell to prospective buyers an option to buy a quantity of that good under prescribed terms—entire financial markets are devoted to the purchase and sale of such options. At its essence, "demand response" consists of the sale by an electricity user of its option to purchase a quantity of electricity; the wholesale market that would be responsible for instantaneously satisfying that electric energy purchase is willing, at the right price, to buy that option and thereby limit what is otherwise the electricity user's right to make that electricity purchase.[11]

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[11] The grid reliability benefits of voluntary reductions in consumer demand are so obvious that transactions of this nature have been available in competitive wholesale markets for almost as long as there have been competitive wholesale markets. PJM's wholesale energy market commenced operations in 1999; just a year later, to "stimulate demand side market responses during peak load conditions [for the] summer [of 2000]," FERC approved a pilot program allowing PJM to "contract directly with retail customers" and pay them, based on the wholesale energy market price, for load reductions to help manage emergency conditions. *PJM Interconnection, L.L.C.*, 92 FERC ¶ 61,059, at 61,150-51 (2000). *See also PJM Interconnection, L.L.C.*, 99 FERC ¶ 61,227, at 61,934 (2002) ("[P]romoting demand response in PJM . . . will enable PJM to better manage its supply and demand imbalances."). FERC approved a similar trial program, also fifteen years ago, for the California wholesale market, seeking to "enlist individuals or groups willing to provide a net demand reduction" and paying them wholesale market compensation in order to "facilitate the participation of these resources in support of grid reliability." *Cal. Indep. Sys. Operator Corp.*, 91 FERC ¶ 61,256, at 61,894 (2000).

As noted, demand response transactions are not unlike options found in other commodity markets. Nor are they unusual in the wholesale electricity markets, which offer examples of other financial and "option-like" products.[12] For example, PJM and other system operators conduct FERC-regulated capacity markets, which are designed to help ensure that sufficient generating capacity is installed and available to meet the system's peak needs. As this Court itself has

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[12] Indeed, the financial characteristics of RTO markets are sufficiently pronounced to have raised the question of whether products in these markets might be jurisdictional under the Commodity Exchange Act—a question that came into particular focus with the expanded jurisdiction Congress granted to the CFTC over options and swaps under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). Rather than attempt to resolve questions of competing regulatory jurisdiction between the CFTC and FERC, PJM and other system operators requested and received from the CFTC an order that generally exempts (to the extent necessary) certain enumerated products transacted in FERC-regulated electricity markets. *Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations To Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas From Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act*, 78 Fed. Reg. 19,880 (Apr. 2, 2013) ("*Final ISO-RTO Exemption Order*"). Demand Response is one such specifically enumerated product covered by the exemption. *Id.* at 19,913 (expressly exempting "Demand Response" transactions defined as "the right of [the requesting system operators] to require that certain sellers of such rights curtail consumption of electric energy from the electric energy transmission system operated by a Requesting Party during a future period of time as specified in the [system operator's] Tariff.").

explained "[i]n a capacity market, in contrast to a wholesale-energy market, an electricity provider purchases from a generator an option to buy a quantity of energy, rather than purchasing the energy itself." *NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n*, 558 U.S. 165, 168 (2010).

Similarly, in certain circumstances where generators have a right under PJM's rules to produce electricity, PJM will ask them *not* to generate and will *pay* them to forego their right to sell electricity. In some cases, generators are asked to stand "in reserve" until called upon, and the generators are paid for this reserve product plus a "lost opportunity cost" if the price received for the reserve product is less than what the generator would have realized by instead generating and selling electricity.[13] Other rules pay a generator that was committed to produce electricity *not* to generate that electricity because system conditions have changed in real time such that electricity from that resource would potentially harm reliable operation of the system.[14] In these situations a generator has a

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[13] *See, e.g.*, *Frequency Regulation Compensation in the Organized Wholesale Power Markets*, Order No. 755, 2008-2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,324, at P 102 (2011) ("Regarding cross-product opportunity costs, which reflect the foregone opportunity to participate in the energy or ancillary services markets, the Commission finds that it is appropriate for the RTOs and ISOs to calculate this and include it in each resource's offer to supply frequency regulation capacity, for use when determining the market clearing price and which resources clear."), *reh'g denied*, Order No. 755-A, 138 FERC ¶ 61,123 (2012).

[14] *PJM Interconnection, L.L.C.*, 142 FERC ¶ 61,067, at P 4 (2013) ("PJM explains that units scheduled in the day-ahead energy

"right" to sell electricity in the real-time market based on having earlier cleared the "day-ahead" forward market. If conditions in real-time deviate from those expected in the day-ahead market, such that injections of electricity by the generator are not needed and may even jeopardize reliable operation of the power system, the system operator's tariff will authorize payment to the generator to sell its rights, in essence paying the generator not to generate.

Recognizing, therefore, that the action PJM compensates as "demand response" is *not* consumption, but rather the purchase and sale of an option or right to consume, simply means that demand response is a distinct transaction with a commercial character like other transactions that occur routinely in RTO wholesale markets.[15]

In sum, the court below erred in its view that demand response, which concededly is *not* a retail sale of electric energy, is a "matter" that is solely "subject to regulation by the states." States do not regulate all matters by which an electricity user can reduce its

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market, but not run in real-time by request of PJM, are subsequently made whole through lost opportunity cost payments.").

[15] In financial terms, an "option" affords its holder a right, but not an obligation, to buy (a "call") or sell (a "put") a specified amount of a commodity at a specified price. The call option-like character of demand response transactions in RTO markets, aptly described by the CFTC as involving a system operator requiring "sellers of such *rights*" to "curtail consumption," *Final ISO-RTO Exemption Order* at 19,913 (emphasis added), demonstrates a transaction of a financial nature, distinct from the physical sale of electricity to the retail consumer.

demand for electricity or its total effective cost of obtaining the electricity it does need. The user can comply with all applicable state requirements yet *still* exercise a choice to reduce its consumption. That election to reduce consumption can then serve as the foundation for a distinct commercial transaction in the wholesale market. As discussed above, that transaction brings together the electricity user's willingness to forego an increment of consumption that the wholesale market would otherwise be obligated to satisfy instantaneously, and the wholesale market operator's objective to match generation and consumption in the most economically efficient manner, at a price acceptable to both parties.

c. The *EPSA* Court's Crabbed View that Demand Response *Must* Be Solely "Part of" the Retail Market Is at Odds with This Court's Recent Guidance that Certain Activities that Affect Both Wholesale Rates and Retail Rates May Be Addressed, in Separate and Appropriate Ways, by Both FERC and the States

The situation presented here is thus similar to that addressed by the Court in its recent *Oneok* decision. *See Oneok*, 135 S. Ct. 1591. As in that case, a given practice or activity may properly be a legitimate concern of *both* state and federal regulators when it plainly has separate and substantial impacts on both retail and wholesale rates. *Id.* at 1600 ("[A] single physical action, such as reporting a price to a specialized journal, could be the subject of many different laws no one could claim that FERC's

regulation of this physical activity for purposes of wholesale rates forecloses every other form of state regulation that affects those rates."). Just as the state had a legitimate interest in addressing the adverse effects of manipulative gas price reporting on retail purchasers (in addition to FERC's interest in addressing the impacts on wholesale customers from that price reporting), so too does FERC have a legitimate, distinct role to play when a reduction in consumption is offered into the wholesale market, with obvious (and intended) impacts on that market. The Court's observation that the "Platonic ideal" of "a clear division between areas of state and federal authority . . . does not describe the natural gas regulatory world," *Oneok*, 135 S. Ct. at 1601, fits equally well here, where a reduction in consumption instantaneously reduces both retail and wholesale demand. Consistent with *Oneok*, the FPA's declaration that certain matters are regulated by the states, not FERC, still leaves room for FERC to set payment and other terms enabling reductions in consumption to be offered as a distinct transaction in the wholesale market, while the state still comprehensively regulates the retail sale at the reduced consumption level.

The *EPSA* court's conclusion, therefore, that the FPA unambiguously confines demand response to a retail realm, and forecloses FERC even from setting the terms for demand response when it is offered as a distinct, independent transaction into the wholesale market, finds no support in the statute and ignores the inherent capability of demand response to aid both reliability and economic efficiency in the wholesale market.

3. Claims that the Text of the FPA Plainly Forecloses FERC Regulation of Demand Response Participation in Wholesale Markets Cannot Be Squared with Other Statutory Text in Which Congress Expressly Encourages Demand Response Participation in Wholesale Markets

As shown above, nothing in the FPA directly addresses and forecloses FERC regulation of demand response participation in the wholesale markets. Moreover, any claim that "the statutory scheme as a whole," *EPSA* at 222 n.1, forecloses regulation of such participation ignores the statutory text in which Congress *has* most "directly spoken" to the "question at issue." In section 1252(f) of EPAct 2005, Congress declared that "[i]t is the policy of the United States that unnecessary barriers to demand response participation in energy, capacity and ancillary services markets shall be eliminated."

The Congressional reference to "energy, capacity and ancillary services markets" plainly encompasses FERC-jurisdictional markets. "Ancillary services," for example, is a term coined by FERC to refer to several services, traditionally provided by generators, that support various aspects of short-term reliability on the transmission grid. *See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 31,036, at 31,705 (1996), *order on reh'g*, Order No. 888-A, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,048, *order on*

reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *reh'g denied*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part & remanded in part sub nom. Transmission Access Policy Study Grp. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. N.Y. v. FERC*, 535 U.S. 1 (2002) ("We will retain the term 'ancillary services,' which will refer to those interconnected operations services that we will require transmission providers to include in an open access transmission tariff."). Similarly, at the time of EPAct 2005, wholesale energy markets were prevalent. The system operators for New York, New England, the Mid-Atlantic, and the Midwest all operated wholesale markets for the sale of electric energy. *See, e.g., Wis. Pub. Power, Inc. v. FERC*, 493 F.3d 239, 250 (D.C. Cir. 2007) (describing proposed and existing RTO "bid-based energy markets" as of 2004). Most RTOs also operated markets for the purchase and sale of installed generating capacity needed to serve forecast peak needs. *See, e.g., New Power Co. v. PJM Interconnection, Inc.*, 98 FERC ¶ 61,208, at 61,757 (2002) (denying complaint regarding alleged improper conduct in PJM's capacity market in 2001). When Congress established as national policy ten years ago that "unnecessary barriers to demand response participation in energy, capacity and ancillary services markets shall be eliminated," it plainly had in mind these wholesale electricity markets.

Moreover, Congressional reference to demand response "participation" in energy, capacity, and ancillary services markets can only be understood as demand response *transacting* in these markets. A "market" is "a place of commercial activity in which goods and services are bought and sold" or "the

enterprise of buying and selling commodities," *Black's Law Dictionary* 1113 (10th ed. 2014). "Participation in," i.e., "the act of taking part in," *id.* at 1294, a market connotes actively engaging in transactions that are the subject of that market. Congress used the term "participation" in these wholesale markets when referring to electricity users providing *demand response*. The straightforward understanding of section 1252(f), therefore, is that Congress established as national policy the elimination of unnecessary barriers to demand response *transacting* in *wholesale* electricity markets.

This understanding is reinforced by the immediately following language of section 1252(f), which declares as U.S. policy that "the benefits of such demand response that accrue to those not deploying such technology and devices but who are part of the same regional electricity entity, *shall be recognized*" (emphasis added). That declared national policy could not be implemented if demand response were not allowed to transact in the wholesale energy markets administered by "regional electricity entit[ies]" like PJM, or if demand response participation in such markets was a "matter" regulated exclusively by the states. For example, demand response provided by end-users in Pennsylvania (part of the PJM regional electricity entity) can instantaneously reduce overall demand such that in many circumstances prices for electric energy consumed outside Pennsylvania are reduced, thereby creating "benefits" that can "accrue" to, for example, "those" in New Jersey (also part of the PJM regional electricity entity) "not deploying such [demand response] technology and devices." EPAct 2005 § 1252(f). Yet if the benefits derived by the PJM

regional energy market from demand response in Pennsylvania were a "matter" that could be regulated solely by the states, then Pennsylvania would have no means of obtaining "recogni[tion]" from PJM energy market purchasers in New Jersey of the "benefits" that "accrue" to those New Jersey parties. Pennsylvania could not compel New Jersey market participants to pay Pennsylvania demand response providers for the benefits of lower energy prices enjoyed by the New Jersey purchasers. By contrast, a FERC-regulated "regional electricity entity" like PJM can implement a multi-state tariff that *pays* the Pennsylvania demand response for clearing in PJM's wholesale energy market and then *charges* New Jersey purchasers from that market to recover some of the cost of those payments, thus fulfilling Congressional policy that "those" in New Jersey to whom "benefits" of the Pennsylvania demand response "accrue" appropriately "recognize[]" those benefits.

The *EPSA* court never successfully squares its interpretation of the FPA with the language of this expression of Congressional intent, simply asserting that FERC's Order 745 "went far beyond removing barriers to demand response resources" and instead "draws demand response resources into the market and then dictates the compensation providers of such resources must receive." *EPSA* at 223-24. The court overlooks that the "barriers" Congress decreed should be "eliminated" are to "*participation*" of demand response in the wholesale "energy, capacity and ancillary services markets." EPAct 2005 § 1252(f) (emphasis added). Thus, the court's fear of "draw[ing] demand response resources *into* the market," *EPSA* at 223-24 (emphasis added), is at odds with Congress's

expressed policy of aiding demand response "participation" in "markets," i.e., demand response transacting in those markets. The court's view that FERC has no authority to regulate demand response participation in wholesale markets simply cannot be reconciled with Congress's expressed support for demand response participation in wholesale markets.

The *EPSA* court also overlooks that, by the time of EPAct 2005, demand response was *already* participating in wholesale markets—as Congress was aware. Only a year before EPAct 2005 was enacted, Congress's investigative arm, the GAO, responded to a Senate inquiry by reporting that "[o]ver the past several years, FERC has approved proposals by grid operators in New York State, New England, and California to incorporate demand-response into the wholesale markets they operate, but these efforts are unique to each grid operator and have not yet attracted significant participation." GAO DR Report at 11. The GAO elaborated to Congress on these "demand-bidding programs [that] allow[] consumers to compete with traditional electricity suppliers in wholesale markets." *Id.* at 16. The GAO distinguished this demand response "wholesale market effort" from the retail demand response programs, such as time-of-use rates, that it described at length in the report, and which it classified as "retail pricing efforts." *Id.* The GAO explained to Congress that the wholesale market "programs, generally established by the grid operator or the local utility, enable mostly large customers to react to changing wholesale prices by offering bids to supply their large blocks of potential demand to the grid operator as if they were a power plant supplying electricity." *Id.*

The *EPSA* court also over-reads other provisions of section 1252, which discuss federal encouragement and support of state demand response programs, in its effort to confine demand response exclusively to state regulation. *EPSA* at 223-24. To the contrary, when read in conjunction with section 1252(f), those provisions reinforce the view that Congress understood that retail demand response should be encouraged *and* demand response participation in wholesale markets should *also* be facilitated. These are not incompatible objectives. To the contrary, supporting demand response through both "retail pricing efforts," and "wholesale market efforts," as GAO categorized them, serves a common goal of more fully realizing the potential benefits of demand response in the electric sector. Given that demand response was *already* being provided in *both* retail programs and wholesale programs for "several years," GAO Report at 11, before EPAct 2005, there is no reason to infer from Congressional encouragement of retail demand response that demand response should not also be allowed to pursue market opportunities in the wholesale markets. Retail and wholesale demand response existed before EPAct 2005; Congress encouraged *both* retail *and* wholesale demand response in EPAct 2005; and demand response opportunities have been further developed and encouraged at both the retail and wholesale levels since EPAct 2005.

Thus, contrary to the court below, FERC is fulfilling, not exceeding, Congress's expressed policy in EPAct 2005, which clearly envisions that "participation" by demand response in wholesale markets is permitted and decrees federal policy that "unnecessary barriers" that hinder that participation

"shall be eliminated." Section 1252(f) thus provides Congress's view on the very question at issue, i.e., whether FERC can approve payment and other terms for demand response in wholesale market tariffs under FERC's "affecting" jurisdiction. Elimination of barriers to demand response participation in FERC-regulated markets *presupposes* that demand response can participate in those markets.[16]

Section 1252(f) also lays to rest any concern about what this case implies for where to draw the line between FERC and state jurisdiction. Because Congress has expressly determined that demand response should be afforded fair access to the wholesale markets, the FPA must be understood to allow FERC to set the terms for demand response participation in those markets. Congress plainly intends that demand response participation in wholesale markets be within FERC's jurisdiction.

In sum, there is no "text" in the FPA that unambiguously forecloses FERC from regulating the terms of demand response offers in the wholesale market. To the contrary, Congress has expressly declared as federal policy that demand response should have a fair opportunity to "participate" in wholesale markets, thus negating any claim that the FPA forecloses FERC regulation of such participation.

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[16] A Congressional policy statement, while not itself a grant of authority, "can help delineate the contours of statutory authority." *Comcast Corp. v. FCC*, 600 F.3d 642, 654 (D.C. Cir. 2010). Such is the case here, as section 1252(f) expressly recognizes demand response participation in wholesale markets, thus placing it squarely within FPA section 206(a)'s pre-existing grant of authority over "practices . . . affecting" wholesale electricity rates.

B. Because Demand Response Offers into the Wholesale Market Directly Affect the Price in that Market, FERC Reasonably Concluded that it May Regulate Demand Response Offers in the Wholesale Market as a "Practice Affecting" Wholesale Market Prices

Once the Court is satisfied that the relevant statutory text does not unambiguously foreclose the agency's assertion of authority, the question under *Chevron* step two becomes whether the agency's construction of the statute as permitting the exercise of authority is reasonable. *Chevron*, 467 U.S. at 843; *City of Arlington*, 133 S. Ct. at 1871. Here, there is little doubt that FERC reasonably concluded that it could regulate the price and terms of demand response offers in the wholesale market as a "practice . . . affecting" the rates in that market within the meaning of FPA section 206(a), 16 U.S.C. § 824e(a). In the wholesale energy markets operated by PJM and other system operators, demand response offers directly affect the market-clearing price in exactly the same way that generation offers affect the clearing price in such markets.

FERC found that replacing in the wholesale energy market an increment of supply increase with the same increment of demand reduction will tend to reduce the market clearing price whenever the electricity user is willing to reduce consumption at a lower price than the generator is willing to increase its output. Order 745 at P 47; *see also* Order 745-A at P 23. Other offers, and the grid's reliability needs at that time, will determine whether, and the extent to which, the demand response offer reduces price—but these are the same factors that determine whether generation offers affect the clearing

price. Under the prevalent economic dispatch approach, PJM and all other regional system operators direct operation of the facilities that will generate energy "at the lowest cost," consistent with "any operational limits of" the relevant generation and transmission facilities. EPAct 2005 § 1234(b).

As FERC recognized in Order 745-A (and the court below accepted), voluntary demand response also affects wholesale rates and service by providing system operators an additional tool to meet grid reliability needs (and avoid *involuntary* demand reductions) and helps to constrain the market power of generators. Order 745-A at P 23; *EPSA* at 221 (recognizing that demand response "will lower the wholesale price" and "increase system reliability"). Under the well-established appellate guidance that FERC's authority under the "practices affecting" language extends only so far as those practices that "directly" affect rates, and that are not "remote" from the rates, *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004); *see also Miss. Indus. v. FERC*, 808 F.2d 1525, 1542 (D.C. Cir. 1987) (practice that "*directly and significantly affect*[s] the wholesale rates" is FERC-jurisdictional) (emphasis added), demand response's direct effects place it comfortably within FERC's jurisdiction. Indeed, a decision of the Court of Appeals for the D.C. Circuit shortly after *EPSA* leaves no doubt that, if demand response regulation is not foreclosed by the FPA's savings clauses, it is well within FERC's "practices . affecting" jurisdiction. In *New England Power Generators Ass'n v. FERC*, 757 F.3d 283, 290 (D.C. Cir. 2014), the court found FERC had authority to set a minimum price for offers into an RTO's wholesale market (in that case, a capacity

market) because below-cost, subsidized offers "directly impact" the market clearing price. If FERC can set a minimum price for offers into an RTO's central market because they directly affect the market clearing price, it clearly can also establish the price and other terms for demand response offers that clear in an RTO's central market, as they also directly affect the clearing price.

The court below dealt in cursory fashion with *Chevron* step two, but it raised three objections in its *Chevron* step one analysis that arguably are relevant to whether FERC's construction of its authority under the "practices . . . affecting" language was unreasonable because it went too far. Each of these objections is misplaced.

First, because the "practices . . . affecting" language cannot authorize FERC to do what other FPA provisions forbid it from doing, the *EPSA* court concluded that a consumer's offer to take the actions necessary to reduce consumption is a "matter" that solely the states regulate and, therefore, under FPA section 201(a), is outside FERC's purview. *EPSA* at 221-22. But this objection arises from the same overbroad view of the "retail market" that, as shown above, led the court astray in concluding that the FPA plainly forecloses FERC's regulation of demand response offers in the wholesale market. As demonstrated above, demand response is concededly not a sale for consumption, and is instead a separate, distinct transaction in the nature of an option, which thus is not a "matter" under exclusive state regulation. Simply put, the nature of demand response is such that it *can* legitimately be expressed in the wholesale

market, and when it is, it is properly a subject of FERC's wholesale regulation. Consequently, the well-established judicial understanding of the extent of FERC's jurisdiction over "practices affecting" wholesale rates (as relied on and applied by FERC) is not in this particular instance curtailed by those FPA provisions that bar FERC from intruding in areas that are subject to exclusive state regulation.

Second, the court below asserted that there was no "limiting principle" to FERC's reliance on the "practices affecting" language, such that FERC's view "could ostensibly authorize FERC to regulate any number of areas, including the steel, fuel, and labor markets." *EPSA* at 221.[17] But the limiting principle is already found in the case law: FERC regulation only extends to those practices *directly* affecting the rate, and not those that are "remote" from the wholesale rate. *Cal. Indep. Sys. Operator*, 372 F.3d at 403. While there may be cases in which it is difficult to apply that judicial gloss because it is not clear when a practice transitions from "direct" to "remote," there is no such difficulty in this case. Demand response offers, and the payment for demand response offers, so directly affect the wholesale market clearing price, i.e., the "rate" for "sales of electric energy at wholesale," that FERC could reasonably find that demand response offers in the

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[17] This second argument might not be distinct from the first argument discussed above. A reasonable reading of the opinion below is that the court faults FERC for not supplying a limiting principle, prompting the court itself to find such a limit in the FPA provisions that delineate the bounds between FERC and state regulation—which the court then finds to be violated in this instance. *See, e.g.*, *EPSA* at 221-22.

wholesale market *very directly* affect prices in that market. And, as shown above, the analysis is made even easier in this case because Congress in section 1252(f) of EPAct 2005 specifically encouraged "participation" by "demand response" in the wholesale "energy, capacity and ancillary services markets."

Nor is there any danger that FERC's construction of the statute will open the door to FERC regulation of "steel, fuel, [or] labor markets." *EPSA* at 221. Steel, fuel, and labor are each separate inputs to the costs of generation supply in the market for wholesale sales of energy; they plainly are not substitutes for that generation supply. Steel, fuel, and labor provide nothing usable to participants in a wholesale energy market until some enterprising developer puts them together into a machine that generates electricity. By contrast, for both PJM's purpose as a system operator and the wholesale market customer's purpose as a purchaser of reliable and economic electric energy, a reduction in consumption can be an equally effective substitute for a generation increase. Unlike steel, fuel and labor, demand is *already* in PJM's wholesale market, the only question is whether PJM (and other system operators) can (subject to FERC regulation) recognize and compensate voluntary action taken to reduce that demand. Contrary to the *EPSA* court, there is no reasonable basis to imagine that FERC regulation of demand response participation in wholesale markets will open the door to FERC regulation of the entire economy.

Third, the *EPSA* court objects that the only reason demand response directly affects rates in the wholesale energy markets is because FERC, by mandating

compensation for demand response, "lured" it into the wholesale market. *EPSA* at 223. A "luring" limitation on agency jurisdiction is not workable and finds no support in the statute or case law. Under the FPA, either a practice affects wholesale rates sufficiently that it should be considered jurisdictional, *see, e.g.*, *New England Power Generators*, 757 F.3d at 290 (low-priced offers into a system operator's capacity market "directly impact the price at which [such market] clears") or it does not sufficiently affect such rates, in which case it should be considered outside FERC's jurisdiction. *Cal. Indep. Sys. Operator*, 372 F.3d at 403 (FERC did not have authority under the "practices . . . affecting" language to direct a system operator to replace its board). Similarly, either a particular matter is subject to exclusive state regulation, or it is not. There is no basis under the FPA, however, for finding that a particular practice very directly sets wholesale prices, but is outside FERC's jurisdiction, simply because the practice entails *compensation to* (i.e. "luring") a market participant.

The *EPSA* court's "luring" concern ultimately seems merely a reiteration of its view that section 201(a) of the FPA bars FERC from setting payment or other terms for demand response in the wholesale market because demand response is a "matter" (in the court's view) subject to exclusive state regulation. In other words, the court uses the charged term "luring" in this context only because it views demand response as properly sheltered on the retail side of the fence, such that FERC's efforts to entice it to the wholesale side are barred by the statute. As shown, however, demand response offered in the wholesale market is not a "matter" regulated by the states, and therefore no text

in the FPA forecloses FERC from regulating such wholesale market demand response offers.

CONCLUSION

For the foregoing reasons, the Court should reverse the judgment of the court of appeals on the first question presented.

Respectfully submitted,

Barry S. Spector
Counsel of Record
Paul M. Flynn
Wright & Talisman, P.C.
1200 G Street, N.W., Suite 600
Washington, D.C. 20005
(202) 393-1200 (phone)
spector@wrightlaw.com
flynn@wrightlaw.com

Vincent P Duane
Senior Vice President and General Counsel
PJM Interconnection, L.L.C.
2750 Monroe Blvd.
Audubon, PA 19403
(610) 666-4367 (phone)
vincent.duane@pjm.com

Craig Glazer
Vice President–Federal Government Policy
PJM Interconnection, L.L.C.
1200 G Street, N.W., Suite 600
Washington, D.C. 20005
(202) 423-4743 (phone)
craig.glazer@pjm.com

Counsel for Respondent
PJM Interconnection, L.L.C.